No. 10272.

IN THE

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United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

San Fernando Mission Land Company, a corporation,

Petitioner,

vs.

Commissioner of Internal Revenue,

Respondent.

PETITIONER'S BRIEF.

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TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

Cases. PAGE

MISCELLANEOUS.

STATUTES.

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I.

Preliminary Statement and Basis of Jurisdiction.

This is an appeal taken from a decision of the United States Board of Tax Appeals holding that there is a deficiency in Petitioner's income tax liability and excess profits tax liability for the calendar year 1938. The Commissioner determined a deficiency in income tax in the amount of $4,508.56 and a deficiency in excess profits tax in the amount of $8,035.64. The deficiency in income tax for the calendar year 1938 was based on the disallowance by the Commissioner of commissions paid by Petitioner

during the calendar year 1938 in the sum of $33,306.88, and the disallowance of attorney's fees in the sum of $250.00, both incurred by Petitioner in connection with oil exploration leases executed by Petitioner as lessor during the calendar year 1938. As far as this appeal is concerned, Petitioner is abandoning its claim that the disallowance by the Commissioner of these two items was improper for the practical reason that the Board's Opinion so treats the claimed expenses that the deduction is not completely disallowed, but merely deferred to a subsequent year.

The sole question to be decided on this appeal is the correctness of the determination by the Commissioner that Petitioner was subject to excess profits taxes for the calendar year 1938 in the sum of $8,035.64.

As appears from an examination of the statutes and regulations, *post,* pages 5 *et seq.* Petitioner would be subject to an excess profits tax for the calendar year 1938 if during any part of the capital stock tax year ending June 30, 1938, Petitioner was "carrying on or doing business" within the meaning of Sec. 601(a) of the Revenue Act of 1938.

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the State of California, with its principal office in the City of Los Angeles, State of California. Petitioner filed its income tax return for the calendar year 1938 and its capital stock tax return for the capital stock tax year ending June 30, 1938, with

the Collector of Internal Revenue at Los Angeles, California, and within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit.

The Commissioner determined a deficiency in excess profits tax liability for the year 1938 in the sum of $8035.64, based on a tax of 12% of $66,963.04 (the net income found by the Commissioner subject to excess profits tax), and the Commissioner denied Petitioner's contention that the corporation was exempt from the excess profits tax as one that was not during the capital stock tax year ending June 30, 1938, "carrying on or doing business" [Tr. pp. 8-12].

Petitioner thereupon filed its petition with the United States Board of Tax Appeals for the redetermination of the deficiency determined by the Commissioner of Internal Revenue.

The case was tried before the Board in Los Angeles, California, on February 6 and 9, 1942, the Honorable John H. Sternhagen presiding.

II.

Specification of Errors Relied Upon.

The points upon which Petitioner intends to rely in this appeal are as follows:

1. The Board of Tax Appeals erred in determining that Petitioner was subject to excess profits taxes for the calendar year 1938.

2. The Board of Tax Appeals erred in failing to find that in the capital stock tax year ending June 30, 1938, Petitioner was not "carrying on or doing business" within the meaning of the applicable statutes and regulations, and decisions interpreting such statutes and regulations.

3. The Board of Tax Appeals erred in failing to find that the Petitioner's activities during the period from July 1, 1937, to June 30, 1938, inclusive, were not the carrying on and doing business for profit, but were, on the contrary, for the purposes of liquidation.

4. The Board of Tax Appeals erred in misapplying to the facts of the case at bar, the holding of the Supreme Court of the United States in the case of *Magruder v. Washington, Baltimore and Annapolis Realty Corporation,* decided April 13, 1942.

5. The Board of Tax Appeals erred in failing to apply to the Petitioner the provisions of the exemptions provided for in Article 43(b) of Regulation 64 (1938 edition).

III.

Statutes and Regulations Involved.

The statutes and regulations which are pertinent to the issues in this appeal are as follows:

Revenue Act of 1938 (52 Stat. 447, ch. 289):

"Sec. 601. Capital Stock Tax.

(a) For each year ending June 30, beginning with the year ending June 30, 1938, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock."

"Sec. 602. Excess Profits Tax.

(a) If any corporation is taxable under section 601 with respect to any year ending June 30, there is hereby imposed upon its net income for the income-tax taxable year ending after the close of such year, an excess-profits tax equal to the sum of the following:

6 per centum of such portion of its net income for such income-tax taxable year as is in excess of 10 per centum and not in excess of 15 per centum of the adjusted declared value;

12 per centum of such portion of its net income for such income-tax taxable year as is in excess of 15 per centum of the adjusted declared value."

Regulations 64 (1938 Edition)—Relating to the Capital Stock Tax:

"Article 1. *Effective date of the tax.*—The capital stock tax imposed by section 601 of the Revenue Act of 1938 is in effect on and after July 1, 1937, and applies with respect to each year ending June 30, beginning with the year ending June 30, 1938."

"Art. 41. *Nature and rate of tax.*—The tax is an excise tax imposed with respect to carrying on or doing business during a taxable year ending June 30, or any fractional part thereof. It is an excise tax upon the exercise of the privilege of doing business and not upon the business itself and is imposed upon each corporation with respect to carrying on or doing business and not upon each business carried on. If more than one corporation is engaged in carrying on a single business, each must file a return and pay the tax. The tax is imposed at the rate of $1 for each full $1,000 of the adjusted declared value of the capital stock. The tax may not be apportioned under any circumstances. If a corporation is engaged in business for any portion of a taxable year, liability for the tax is incurred for the entire taxable year."

"Art. 42. *Doing business.*—The term 'business' is very comprehensive and embraces whatever occupies the time, attention, or labor of men for profit. Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. Similarly, even if not organized for profit, any corporation which engages in activities ordinarily carried on for profit is doing business. It is immaterial whether the activities result in a profit or a loss, or whether the cor-

poration has been successful in its enterprise, or that because of unfavorable business conditions, no operations are carried on for a particular period. No particular amount of business need be done, nor is it necessary that the business be continuous throughout the taxable year.

The case is exceptional in which the activities of a corporation organized for profit do not amount to doing business within the meaning of the Act. Such a case is generally limited to one in which the corporation is not pursuing the ends for which organized, *i. e.,* profit."

"Art. 43. *Illustrations.*—(a) *General.*—In general 'doing business' includes any activities of a corporation whether it engages in—

* * * * * * * *

(5) the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distribution of the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property;

* * * * * * * *

(b) *Exceptions.* — Ordinarily the exceptions to 'doing business' are restricted to limited activities of a corporation. For example—

(1) A corporation is not subject to the tax if its corporate powers are limited to the mere owning and holding of property and the distribution of its avails, or, although incorporated for the purpose of doing business, if it has retired from the business for which it was organized and has reduced its activities to the

mere ownership and holding of property, the distribution of its avails, and doing only such acts as are necessary to the maintenance of its corporate existence and the private management of its purely internal affairs. However, a corporation which has retired from its principal business is subject to the tax if, nevertheless, it engages in other business activities or maintains its organization for the purpose of continued effort in the pursuit of profit or gain.

* * * * * * * *

(3) A corporation will not be regarded as 'doing business' if it had no activities during the entire taxable year, because it has—

(a) become dormant; or

(b) completed its business, as, for example, where a real estate subdivision has been developed, sold and reduced to cash; or

(c) abandoned its business, as, for example, where prospective oil properties are proven worthless."

"Art. 44. *Declared value.*—In its return for each declaration year, a corporation must declare a definite and unqualified value for its capital stock. The declaration of value must be made in terms of United States dollars and be specific, as, for example, $10,000, or 'Zero,' in the event it is desired to indicate no value. Inasmuch as the declared value can in no case be less than zero, a declaration of a deficit or minus figure shall be considered a declaration of 'Zero.'

* * * * * * * *

T. D. 4829, 1938-2 D. B., 98 (Declared Value Excess Profits Tax Regulations).

IV.

Statement of the Case.

As stated above, if the Petitioner was "carrying on or doing business" for any part of the period from July 1, 1937, to June 30, 1938, then under section 601(a) and section 602(a) of the Revenue Act of 1938, Petitioner became liable for an excess profits tax on its net income for the calendar year 1938, computed in accordance with section 602(a). The sole issue is, therefore, whether the Petitioner was or was not "carrying on or doing business" during the period of July 1, 1937, to June 30, 1938.

The facts are entirely undisputed, consisting of the oral testimony of Petitioner's assistant secretary and Petitioner's president and corroborative documentary evidence, consisting principally of corporate records, minutes of stockholders' and of directors' meetings, leases, and miscellaneous correspondence with stockholders, etc. The crux of the difference of attitude between the Petitioner and the Commissioner lies in a difference in interpretation and emphasis of the uncontraverted facts.

Petitioner claims that during the capital stock tax year in question it was not "carrying on or doing business" within the meaning of the basic tax statute and the Commissioner's own Regulations as they have been interpreted by the courts; that whatever activities took place were reasonably related to a well-defined prior program for liquidation and gradual distribution of its corporate assets to its stockholders. The Commissioner, on the other hand, claims that the corporation carried on sufficient activities during the period in question to constitute "carrying on or doing business." The event which focused attention upon the particular year in question was the

receipt by Petitioner during the calendar year 1938, but subsequent to June 30, 1938, of the sum of $20,000 in cash and a speculative consideration of certain moneys to be paid out of oil if, as, and when discovered, in connection with a lease executed by Petitioner to the Tidewater Associated Oil Company on the 26th day of August, 1938, and the additional sum of $76,130.00 as a bonus paid to Petitioner by the Shell Oil Company in connection with the lease executed to it on the 25th day of November, 1938. Both of these leases were for oil exploration purposes. Neither during the calendar year 1938 nor to date has any oil been discovered on Petitioner's property.

Rather than to restate the factual background leading to this controversy, all of which appears in condensed form in the Statement of Evidence [Tr. pp. 45-117], there is presented below a condensation in summary form of the principal facts which are necessary for the determination of the issue of "carrying on or doing business." In presenting this summary we have given fair emphasis to all facts which have been referred to in earlier proceedings by Petitioner, by the Commissioner, and by the Board in its Findings of Fact [Tr. pp. 14-17] and in its Opinion [Tr. pp. 17-19]:

1. The petitioner is a California corporation, organnized on December 3, 1904. [Petitioner's Exhibit No. 3.]

2. The purposes for which the Petitioner was organized were the buying and selling of land and water and the subdividing of land for sale, and purposes incidental thereto. [Petitioner's Exhibit No. 3.]

3. The original capital stock of the Petitioner was One Million Dollars, divided into 10,000 shares, all of which were issued. [Petitioner's Exhibits No. 3, 4, and 20.]

4. During the year 1905, the Petitioner acquired approximately 16,000 acres of land and commenced actively to engage in the business for which it was organized. [Petitioner's Exhibit No. 5.]

5. The Petitioner actively pursued the purposes for which it was organized and by the year 1923, the Petitioner had disposed of all but approximately 200 acres of its original 16,000 acres of land. [Tr. pp. 56-57.]

6. From incorporation until January 29, 1923, the Petitioner paid cash dividends to its stockholders in the sum of $2,050,000.00. [Petitioner's Exhibits 7 and 9 to 23, both inclusive.]

7. On May 20, 1918, the Petitioner paid a dividend to its stockholders of $1,000,000.00 in land. [Petitioner's Exhibits No. 7 and 15.]

8. No dividends were paid by Petitioner between January 29, 1923, and June 30, 1938, the closing date of the capital stock tax year in question. [Tr. p. 53.]

9. On April 17, 1919, the Board of Directors of the Petitioner appointed a committee for the purpose of devising and submitting a plan of segregating or distributing all of the remaining lands of the corporation. [Petitioner's Exhibit No. 14.]

10. On January 24, 1921, the Board of Directors of the Petitioner adopted a resolution to reduce the Petitioner's capitalization from $1,000,000.00 to $100,000.00, and the Petitioner's capital was formally reduced in conformity thereto. [Petitioner's Exhibits No. 20 and 4.]

11. No meetings of the Board of Directors were held during the period between February 2, 1927, and September 14, 1936. [Tr. p. 68.]

12. On September 14, 1936, four of the seven directors of the Petitioner had previously died and had not been replaced. Vice-President J. F. Sartori had for-

gotten that he held that office. The Petitioner's president had died and had not been replaced. [Tr. pp. 91-92.]

13. No meetings of the stockholders of the Petitioner were held between May 28, 1918, and September 14, 1936. [Tr. p. 68.]

14. In 1936, R. F. Ingold, on behalf of the Angeles Mesa Land Company, a 10% stockholder of Petitioner, in undertaking to collect advances made by it to Petitioner over a period of years for conserving Petitioner's assets, learned that Petitioner had no funds with which to pay its obligation. A plan was devised whereby a stockholders' meeting would be called, directors elected, an assessment against stockholders levied to furnish funds to pay the debt, and a dissolution of the corporation be then made as rapidly as possible. [Tr. pp. 91-94.]

15. California Franchise Tax Returns filed for the years 1926, 1927, and 1928, stated that the Petitioner was being wound up and was practically liquidated. [Petitioner's Exhibits No. 47, 48 and 49.]

16. Correspondence between the Petitioner and several stockholders between March 16, 1933, and November 22, 1937, indicate that the Petitioner was inactive and that it was the intent of the Petitioner to liquidate. [Petitioner's Exhibits No. 39 to 46, both inclusive.]

17. The intention of the management of the Petitioner between 1925 and 1938 was to sell the remaining properties of the Petitioner and to spend a minimum in maintenance to preserve the properties until sold. [Tr. pp. 59-60.]

18. The only reason the Petitioner was not dissolved prior to 1938, was because it was not practicable to distribute its few remaining properties among its stockholders and the management attempted to sell its properties so that a cash liquidation might be made. [Tr. p. 80.]

19. During the six and one-half year period from January 1, 1931, to June 30, 1937, the beginning date of the capital stock tax year in question, the Petitioner's entire activities consisted of the following:

Its Income was derived from sale of oranges and lemons produced from a grove located on part of the original land owned by the Petitioner; one sale of its real property for $1,500.00 in 1932; one sale of oil reservations in 1936 for $7,500.00; release of an oil lease in 1931 for $10.00; and rent of pasture land in 1935 for $75.00.

Its Expenses consisted of maintenance of the orange and lemon grove; real estate taxes; payment of state franchise tax, and federal capital stock tax; interest on money owed; administration expense paid for the year 1936; and an inconsequential item of $43.10 of general expenses. [Petitioner's Exhibit No. 38 and Tr. pp. 64-68.]

20. The Land and Mineral Interests in Land owned by the Petitioner on July 1, 1937, were the same as were owned by the Petitioner on December 31, 1930. [Tr. pp. 62-63.]

21. The financial condition of the Petitioner between December 31, 1930, and July 1, 1937, indicates that its assets were practically the same, and its liabilities were increased on the latter date principally because of unpaid real estate taxes extending over the period. [Petitioner's Exhibits No. 36 and 37.]

22. The Petitioner acquired no property subsequent to 1925. [Tr. pp. 79-80.]

23. The income derived by the Petitioner subsequent to July 1, 1938, arose out of events occurring after July 1, 1938, and were unforeseen by the Petitioner or its officers on or prior to June 30, 1938. [Tr. pp. 102-103.]

24. The negotiations with the Tidewater Associated Oil Company resulting in an oil and gas lease bearing date of August 26, 1938 [Petitioner's Exhibit No. 30],

did not commence until August 19, 1938, and that was the first knowledge the officers of Petitioner had of this transaction. [Tr. p. 103.]

25. On August 26, 1938, Petitioner entered into an agreement with Robert V. New to pay him a commission on any oil and gas lease to be negotiated by him on certain property owned by the Petitioner. New was to receive no compensation for his services in the event the bonus payment for the lease amounted to $25.00 per acre or less, and he was to receive 50% of whatever consideration was received in excess of $25.00 per acre. [Petitioner's Exhibit No. 26.]

26. Robert V. New negotiated an oil and gas lease with the Shell Oil Company, dated November 25, 1938, as a result of this employment. [Tr. p. 107.]

27. The oil and gas lease executed between the Petitioner and the Shell Oil Company, dated November 25, 1938, covered 380.65 acres of land, and a bonus of $200.00 per acre was paid upon its execution, making a total bonus paid thereon of $76,130.00 in 1938. [Petitioner's Exhibit No. 29.] The bonus above mentioned represented all sums required to be paid by the Lessee during the term of the lease, excepting royalties on oil and gas when, as and if produced on the property, the lease provided that drilling operations should commence on or before two years from the execution of the lease, and the lease was to be in effect for so long as drilling operations continued. [Petitioner's Exhibit No. 29.]

28. Robert V. New was paid the sum of $33,306.88, in 1938, based solely on the agreement terms and on the $76,130.00 bonus received from the Shell Oil Company. [Petitioner's Exhibit No. 52.]

29. No oil has been discovered on the property leased to the Shell Oil Company to date. [Tr. p. 105.]

30. The Petitioner fixed a capital stock tax value of zero in its 1938 Capital Stock Tax Return which it filed in July, 1938, and it would not have done so had

it known it would have received any income in 1938. [Tr. p. 102.]

31. The Statement of Financial Condition as of June 30, 1938, reflects no substantial changes from that of July 1, 1937. [Petitioner's Exhibits No. 37 and 51.]

32. There is set out below, in a detailed breakdown, the financial condition of Petitioner as of July 1, 1937, as reflected in its financial statement [Petitioner's Exhibit No. 37]:

(a) On July 1, 1937, the Petitioner's financial statement consisted of the following:

ASSETS

Cash in Bank		$ 479 65
Land		
Parcel 1—Orange and Lemon Grove	$52 500 00	
Parcel 2—Unplotted Hill Lands	13 800 00	66 300 00
Mineral Interests in Land		1 00
Total Assets		$66 780 65

LIABILITIES AND CAPITAL

Liabilities—Accrued Taxes and Accounts Payable	$ 8 218 60
Net Worth	58 562 05
Total Liabilities and Capital	$66 780 65

[Petitioner's Exhibit No. 37.]

(b) "Land—Parcel 1—Orange and Lemon Grove," on July 1, 1937, was a "tail-end" piece of the original

16,000 acres of property acquired by the Petitioner. [Tr. p. 59.] The grove was planted to Navel oranges and this locality was not a good navel district. [Tr. p. 59.] An overhead sprinkling system prevented proper cultivation of the land. [Tr. p. 59.] It was infested with scale and Johnson grass. [Tr. p. 59.] The Petitioner received notices from the Horticultural Department, State of California, to thoroughly fumigate and take care of the grove, or make some other disposition of it. [Tr. p. 62.] The Petitioner had spent a minimum amount of money in maintaining the grove because the Petitioner did not have the funds. [Tr. p. 60.] Property taxes were not paid for many years. [Tr. p. 60.] It had been apparent that the grove was not self-sustaining and could never be operated at a profit. [Tr. p. 75.] During the fiscal year ended June 30, 1938, the trees were pulled out at a cost of $456.75 and the grove abandoned. [Tr. p. 75.] The grove was sold to the State for delinquent taxes and has never been redeemed. [Tr. p. 76.]

(c) "Land—Parcel 2—Unplotted Hill Lands," on July 1, 1937, was a "tail-end" piece of the original 16,000 acres of property acquired by the Petitioner. [Tr. p. 60.] This property was unimproved, without water, utilities, or streets. [Tr. p. 60.] It was remote from any established residential section. [Tr. p. 60.] During the fiscal year ended June 30, 1938, a sale of 4.75 acres of this land was made at a gross price of $2,365.00. [Tr. p. 72.] The remaining land has not been sold because no buyer could be found. [Tr. p. 73.]

(d) "Mineral Interests in Land," on July 1, 1937, was a reservation of mineral interests in approxi-

mately 3,000 acres of land previously sold by the Petitioner. The land was part of the original 16,000 acres of property acquired by the Petitioner. [Tr. p. 62.] The oil reservations owned by the Petitioner were originally withheld for 50 years in connection with a sale of certain land to The Sunshine Co. in 1919, because the sale of the surface was made at a very low price. [Tr. p. 98 and Petitioner's Exhibit No. 31.] The withholding of oil rights is common practice in order to take away the incentive to drill for oil on residential property such as was the property of the Petitioner. [Tr. p. 102.] No oil has ever been found on the Petitioner's property. [Tr. p. 105.] To June 30, 1938, the Petitioner had no knowledge of any oil showings on adjacent land. [Tr. p. 104.] No oil surveys have ever been made on the property of the Petitioner. [Tr. p. 89.] The oil reservations never had other than a speculative or unknown value at any time. [Tr. p. 87.] The Petitioner never released any oil reservations except to the owners of the surface rights. [Tr. p. 90.] During the fiscal year ended June 30, 1938, the Petitioner made only one sale of its oil reservations and that was to the surface owner, John O'Melveny, for the sum of $1,180.00. [Tr. p. 89.] During the fiscal year ended June 30, 1938, the Petitioner proposed to enter into an oil and gas lease with one William McClintock but this lease was never delivered and the Petitioner never received any consideration for it. [Petitioner's Exhibit No. 24 and Tr. pp. 98-99.] During the fiscal year ended June 30, 1938, the Petitioner leased certain mineral rights to one A. Llewellyn Howell for which it received no consideration at time of execution and which provided for deferred rental. [Petitioner's Exhibit No. 28 and Tr. pp. 99-100.]

(e) The income and expenses of the Petitioner for the fiscal year ended June 30, 1938, consist of the following:

INCOME

Final Proceeds from Sale of Oranges and Lemons		$ 51 87
Refunds—Packing House and Railroad Claims		39 01
Profit on Sale of 4.75 Acres of Land		1 890 00
Proceeds from Sale of Oil Reservation		1 180 00
Rental of Pasture		50 00
Received from Agricultural Conservation		59 78
Total Income		$3 270 66

EXPENSES

Orange Grove Expenses	$1 565 34	
Real Estate Taxes—Hill Land	745 11	
Cost of Pulling Trees—Grove Abandoned	456 75	
General Expenses	79 14	
Franchise Tax	25 00	
Capital Stock Tax	1 00	
Title Charges on Sale of Property	25 00	
Total Expenses		2 897 34
Net Income for Period		$ 373 32

[Petitioner's Exhibit No. 50.]

(f) Final Proceeds from Sale of Oranges and Lemons, in the amount of $51.87, represents the entire income from the grove for the period until the trees were pulled out. [Tr. p. 72.]

(g) Refunds from Packing House and Railroad Claims, in the amount of $39.01, represent repayments of withholds in prior years and for fruit spoilage and were final payments received by the Petitioner. [Tr. p. 72.]

(h) Rental of Pasture Land in the amount of $50.00 was received for the use of the Petitioner's hill lands during the fiscal year. [Tr. p. 73.]

(i) Proceeds received from the Agricultural Conservation Program, in the amount of $59.78, was for non-planting of the orange grove. [Tr. p. 73.]

(j) Orange Grove Expenses, in the amount of $1,565.34, represents expenses incurred prior to the time the grove was abandoned. The expenses represent the minimum expense possible. Property taxes reflected as expenses were not paid. [Tr. p. 74.]

(k) Real Estate Taxes—Hill Land, in the amount of $745.11, represents the current year's taxes, the only portion of which was paid was that on the 4.75 acres of land sold during the period. [Tr. p. 75.]

(l) General Expenses, in the amount of $79.14, consist of surveying and blue printing the 4.75 acres of land sold during the period. [Tr. p. 76.]

(m) Franchise Tax, in the amount of $25.00 is the minimum payment required by the State of California to maintain the Petitioner's corporate franchise. [Tr. p. 76.]

(n) Capital Stock Tax, in the amount of $1.00, represents the 1937 Capital Stock Tax declaration. [Tr. p. 76.]

(o) Title Charges, in the amount of $25.00, is in payment of costs in connection with the sale of the 4.75 acres of land. [Tr. p. 76.]

33. The only other transactions engaged in by Petitioner in the period of July 1, 1937, to June 30, 1938, not reflected in the financial statement outlined in detail hereinabove were the following:

(a) The Petitioner loaned the Angeles Mesa Land Co., a stockholder, the sum of $1,500.00 during the fiscal year ended June 30, 1938, on open account without interest, being purely an accommodation loan. [Tr. p. 77.]

(b) During the fiscal year ended June 30, 1938, the Petitioner paid certain liabilities outstanding against it on July 1, 1937, which represented transactions prior to July 1, 1937. [Tr. pp. 77-78.]

(c) The only other transactions of the Petitioner during the fiscal year ended June 30, 1938, consisted of action by the Board of Directors in granting a right of way to the City of Los Angeles through the Petitioner's grove property for road purposes for which is received no consideration. [Tr. p. 101 and Petitioner's Exhibits No. 24 and 25.]

34. (a) Its Board of Directors at a meeting held on July 2, 1917, approved the sale of certain land, subject to the reservation by the Petitioner of all mineral rights. [Petitioner's Exhibit 10.]

(b) A directors' meeting, held on January 10, 1918, authorized the execution of an oil lease for a one-eighth royalty to be paid to Petitioner. [Petitioner's Exhibit 11.]

(c) A directors' meeting held on April 17, 1919, authorized the sale of three parcels of Petitioner's real estate, subject, in each case, to the reservation of all oil, gas and mineral rights. [Petitioner's Exhibit 14.]

(d) On May 23, 1919, a deed to certain of Petitioner's lands was executed to the Sunshine Company, a California corporation, reserving to the Petitioner, for a term of fifty years, all oil and gas rights. [Petitioner's Exhibit 31.]

(e) The directors' meeting of August 14, 1925, considered certain proposed oil leases upon the Petitioner's property. [Respondent's Exhibit H.]

(f) The directors' meeting of February 2, 1927, considered proposed oil leasing propositions submitted to the Petitioner by the Title Insurance and Trust Company, and by the Shell Oil Company. The meeting approved the execution, in consideration of the sum of $2,940.00, of quitclaim deeds releasing oil rights to certain acreage which had been previously sold by the Petitioner. The meeting also voted not to authorize the execution of any more oil releases by the Petitioner "for the present, at least." The meeting authorized the president of the Petitioner to enter into negotiations with the Shell Oil Company for the leasing of certain lands of the Petitioner for oil drilling purposes, provided that the Shell Oil Company would offer not less than $12,000.00 to be paid in advance as a bonus, and a one-sixth royalty. The meeting refused to quitclaim the Petitioner's oil and gas rights under the land conveyed to the Sunshine Company by the deed of May 23, 1919, Petitioner's Exhibit 31. [Petitioner's Exhibit 6.]

(g) A meeting of the Board of Directors held on September 14, 1936, considered an offer of $7,500.00 made by the Associated Oil Company for oil rights reserved by the Petitioner under a part of the Sunshine Ranch. The meeting also authorized the sale of these oil rights for the best price obtainable. The meeting also considered and decided not to execute a proposed oil and gas lease to the Progressive Syndicate as lessee, covering approximately 858 acres of the Sunshine Ranch. The meeting also considered a request by the California Trust Company relative to oil rights reserved by the Petitioner under certain other acreage of the Sunshine Ranch, and decided that no disposition of these oil rights would be made at the time. [Petitioner's Exhibit 2.]

35. Petitioner received income in 1938, 1939 and 1940 from its leases, executed after June 30, 1938, and paid dividends to its stockholders in each of these years. This income, however, was not received from oil royalties, but only from bonuses and deferred rentals. [Petitioner's Exhibit 27 and Respondent's Exhibits J, K, L, and Tr. p. 84.]

V.

ARGUMENT.

Petitioner Was Not "Carrying on or Doing Business" Between July 1, 1937, and June 30, 1938, Within the Meaning of Section 601(a) of the Revenue Act of 1938, as Interpreted by the Courts.

SUMMARY:

A. *The broader criteria for "carrying on or doing business" for capital stock tax purposes as declared by the Courts.*

1. Each case must depend upon the particular facts presented to the Court.
2. The activities of the corporation and the situation must be judged as a whole; likewise, the past history of the corporation should be read and studied for the light it may throw on its current dealings or its inactivity.
3. A corporation may well reach a stage of quietude and passivity for a particular capital stock tax period, bringing it within the exemption from the tax, and yet the same corporation may resume its activities shortly thereafter with a sufficient tempo to bring itself within the tax liability.
4. A strong indication of not "carrying on or doing business" would be the corporation's failure to invest its income in new enterprises, limiting itself rather to the distribution of its income to its stockholders.
5. If the corporation has abandoned its charter purposes for profit and is engaged principally in liquidating or "distributing its avails," then it is no longer "carrying on or doing business."

B. *More specific guides for determining whether a corporation is "carrying on or doing business" for capital stock tax purposes.*

1. A corporation is not "carrying on or doing business" merely because it maintains its corporate existence, or in addition thereto does whatever is reasonably necessary towards that end, as for example, maintains an office, pays taxes, holds meetings of stockholders or directors, pays its officers, realizes profits from its own investments, etc.

2. A corporation is not "carrying on or doing business" for capital stock tax purposes even though it takes reasonably necessary steps to maintain its properties and conserve its assets.

3. A corporation is not "carrying on or doing business" for capital stock tax purposes even though it engages in business activities and realizes profits from its own assets, if these activities are not in furtherance of the purposes for which it was created, but rather are reasonably directed toward a program of liquidating its business and distributing its assets to its stockholders.

4. If there is found to be an intention to liquidate, whether formally expressed or implied from its activities, then a corporation is not "carrying on or doing business" merely because it puts forth its best efforts in disposing of its assets for revenue purposes.

C. *Cases most nearly analogous to the facts disclosed by the record herein, where courts have held the corporation was not "carrying on or doing business" for capital stock tax purposes.*

D. *The Supreme Court decision in Magruder v. Washington, etc. Realty Corporation in no way changes the applicability of the rules theretofore enunciated by the Court in so far as the facts reflected in the record herein are concerned; and the Board of Tax Appeals was clearly in error when it based its ruling adverse to Petitioner on the authority of the Magruder case.*

E. *Viewed in the light of the applicable judicial guides which have interpreted Section 601(a) of the Revenue Act of 1938, the record in this case indisputably shows that the Petitioner was not "carrying on or doing business."*

1. The record shows a clearly defined intention by Petitioner to liquidate its assets as rapidly as conditions warranted.

2. Such activities as Petitioner engaged in, during the capital stock tax year in question, were not carried on in furtherance of the purposes for which it was incorporated, but rather were reasonably related to (a) the maintenance and preservation of its properties and assets, and (b) the orderly disposal and liquidation of its properties and assets; and

3. The isolated transactions during the taxable year in which Petitioner granted an option or lease for oil exploration purposes did not indicate the seeking of a new source of prolonged business, but rather merely an attempt to create an additional value to the assets which it had for some time past been seeking to liquidate.

Petitioner Was Not "Carrying on or Doing Business" Between July 1, 1937, and June 30, 1938, Within the Meaning of Section 601(a) of the Revenue Act of 1938, as Interpreted by the Courts.

A. The Broader Criteria for "Carrying On or Doing Business" for Capital Stock Tax Purposes as Declared by the Courts.

There is as much difficulty reflected in judicial attempts to fix guideposts for determining "carrying on or doing business" in the rather narrow field of capital stock tax liability as we know exists in generally determining a "doing business" status of corporations for other purposes.

There would, therefore, be no useful purpose served in an exhaustive recital of the array of decisions which have dealt with the problem of whether a particular corporation was or was not "carrying on or doing business" for a particular capital stock tax year.

Rather, we shall first attempt to discuss a few leading Supreme Court decisions which generally have laid down interpretive guides, and then go on to analyze a selected number of Circuit Court of Appeals, District Court, and Court of Claims cases which we are satisfied are very close to the factual situation with which we are here dealing. There is a long series of Supreme Court cases which dealt with the problem of determining whether or not a corporation was "doing business" within the meaning of the Corporation Tax Law of 1905. Although the present capital stock tax and its coordinate, the excess-profits tax, were originally enacted on June 16, 1933, as Title II of the National Industrial Recovery Act, the interpretive problem in both instances has been treated as identical.

Of the earlier Supreme Court cases, four may be singled out as determinative, namely, *McCoach v. Minehill etc. Rd.*

Co. (228 U. S. 295); *Edwards v. Chile Copper Co.* (270 U. S. 452); *United States v. Emery, Bird, Thayer Co.* (237 U. S. 28), and *Von Baumbach v. Sargent Land Co.* (242 U. S. 503, 516).

In *McCoach v. Minehill etc., supra,* the Court laid down this guide:

> "The distinction is between (a) the receipt of income from outside property or investments by a company which is otherwise engaged in business, in which event the investment income may be added to the business income in order to arrive at the measure of the tax; and (b) the receipt of income from property or investments by a company that is not engaged in business except the business of owning the property, maintaining the investments, collecting the income, and dividing it among its stockholders. In the former case, the tax is payable; in the latter, not." (p. 308.)

In the case of *United States v. Emery, Bird, Thayer Co., supra,* Mr. Justice Holmes added the sage observation:

> ". . . The question is rather what the corporation is doing than what it could do."

In *Edwards v. Chile Copper Co., supra,* Mr. Justice Holmes further pointed out that:

> "The cases must be exceptional when such activities of such corporations do not amount to doing business in the sense of the statute. The exception 'when not engaged in business' ordinarily would seem pretty nearly equivalent to when not pursuing the ends for which the corporation was organized, in the case where the end is profit."

The interpretive rules, however, became best crystalized in the most-often-referred-to case of *Von Baumbach v. Sargent Land Co., supra,* where the Court said:

> "It is evident from what the Court has said in dealing with the former cases that the decision in each in-

stance must depend upon the particular facts before the court. The fair test to be derived from the consideration of all of them, is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes."

This judicial exemption from the "carrying on or doing business" status of a corporation which is principally engaged in activities related to the holding of its properties and the "distribution of its avails" became the basis for a regulatory exemption adopted by the Commissioner of Internal Revenue as Regulations 64 (1938 edition), Article 43(b) (1), set out *supra*, page 7.

Summarizing, the broader guides for determining whether a corporation is or is not "carrying on or doing business" for capital stock tax purposes are as follows:

1. **Each Case Must Depend Upon the Particular Facts Presented to the Court. (This, of Course, Accounts in Part at Least for the Great Diversion in Decisions Reached by Trial Courts Since No Two Cases Are Identical in All Details.)**
2. **The Activities of the Corporation and the Situation Must Be Judged as a Whole; Likewise, the Past History of the Corporation Should Be Read and Studied for the Light It May Throw on Its Current Dealings or Its Inactivity.**
3. **A Corporation May Well Reach a Stage of Quietude and Passivity for a Particular Capital Stock Tax Period, Bringing it Within the Exemption From the Tax, and Yet the Same Corporation May Resume Its Activities Shortly Thereafter With a Sufficient Tempo to Bring Itself Within the Tax Liability.**
4. **A Strong Indication of Not "Carrying on or Doing Business" Would Be the Corporation's Failure to Invest Its Income in New Enterprises, Limiting Itself Rather to the Distribution of Its Income to Its Stockholders.**
5. **If the Corporation Has Abandoned Its Charter Purposes for Profit and Is Engaged Principally in Liquidating or "Distributing Its Avails," Then It Is No Longer "Carrying on or Doing Business."**

B. More Specific Guides for Determining Whether a Corporation Is "Carrying On or Doing Business" for Capital Stock Tax Purposes.

Going from the general to the specific, we are able with fair definiteness to formulate a few more tests anent "carrying on or doing business" which bear more closely to the facts of our particular case:

1. A Corporation Is Not "Carrying on or Doing Business" Merely Because It Maintains Its Corporate Existence, or in Addition Thereto Does Whatever Is Reasonably Necessary Towards That End, as for Example, Maintains an Office, Pays Taxes, Holds Meetings of Stockholders or Directors, Pays Its Officers, Realizes Profits From Its Own Investments, etc.

United States v. Hotchkiss Redwood Co. (C. C. A. 9) (1928), 25 Fed. (2d) 958 (analyzed *post*, page 37);

Ambergris Consolidated Mining Co. v. United States (D. C. Idaho) (1939), 27 F. Supp. 968.

Automatic Fire Alarm Co. of Delaware v. Bowers (D. C. S. D. New York) (1931), 51 Fed. (2d) 118:

Taxpayer borrowed small sums temporarily from its subsidaries, for which it paid no interest, and which it used in paying dividends. Occasionally, also, taxpayer made small temporary loans to its subsidaries. They, however, were for convenience only, no interest being charged or paid. Activities also included that of a holding company of stock of a subsidiary operating company, the purchase of a building for a subsidiary for \$325,000 on account of which it loaned subsidiary \$180,000; taxpayer likewise sold stock of a total of \$294,150. *Held:* Not "carrying on or doing business."

United States v. Emery, Bird, Thayer Co., supra:

A corporation which leased its property and franchises for a long term and ceased to pursue the purposes

for which it was organized, but which maintained corporate existence, received rents, made investments, distributed income among stockholders, held annual stockholders' meetings, maintained a board of directors, etc. *Held:* Not "carrying on or doing business."

McCoach v. Minehill etc. Rd. Co., supra:

Taxpayer leased its railroad and ceased operations, but received rentals called for by lease, deposited money at interest, maintained offices, paid salary to officers and clerks, kept stock books for transfer of capital stock, which stock was bought and sold on the market. *Held:* Not "carrying on or doing business."

2. **A Corporation Is Not "Carrying on or Doing Business" for Capital Stock Tax Purposes Even Though It Takes Reasonably Necessary Steps to Maintain Its Properties and Conserve Its Assets.**

Cannon v. Elk Creek Lumber Co. (C. C. A. 7) (1925), 8 Fed. (2d) 996:

Corporation was organized for purpose of bidding in lands. The lands were bid in and the corporation continued to hold the lands waiting for favorable opportunity for disposing of them, and distributing the proceeds, in the meantime paying all taxes, patrolling and protecting property from fire and trespassers and cruising the timber so that the boundaries and the timber possibilities might be known, but not cutting any timber or renting or otherwise making use of the timber or land, save in one instance keeping a few houses on some of it occupied at a nominal rent to prevent their going to ruin. . . . The operation of the timber properties as such was not in contemplation of or for income or profit therefrom, save that it was hoped to dispose of the properties as stated and efforts were made to interest others in their purchase, failing in which the

corporation might operate if sufficient outside capital therefor could be secured. . . . *Held:* Neither the hope that some day someone will come along and buy them out, and thus enable them to distribute the proceeds among the original bondholders coupled with some efforts to bring this about, nor the alternative hope that sometime someone would supply them with sufficient capital to operate the properties is being "engaged in business" within the meaning of the quoted statute.

> *Del Norte v. Wilkinson* (D. C. E. D. Wis.) (1928), 28 Fed. (2d) 876;
>
> *Mid-West Steel Corp. v. O'Toole* (D. C. W. D. Pa.) (1940), 1940 *Prentice-Hall F. T. S.*, par. 63,028.

3. A Corporation Is Not "Carrying on or Doing Business" for Capital Stock Tax Purposes Even Though It Engages in Business Activities and Realizes Profits From Its Own Assets, If These Activities Are Not in Furtherance of the Purposes for Which It Was Created, but Rather Are Reasonably Directed Toward a Program of Liquidating Its Business and Distributing Its Assets to Its Stockholders.

> *Union Land & Timber Co. v. United States* (analyzed *post,* page 33);
>
> *Estate of Isaac G. Johnson v. United States* (analyzed *post,* page 35);
>
> *United States v. Hotchkiss Redwood Co.* (analyzed *post,* page 37);
>
> *S. Makransky & Sons, Inc. v. United States* (D. C. E. Div. Pa.) (1940) (1940 *Prentice-Hall F. T. S.*, par. 62,905):

"In the present case the plaintiff corporation was not engaged in the business for which it was organized. On the contrary, its activities during the tax period were confined to the holding of property, some of which

was being liquidated, the payment of taxes and the payment of insurance premiums by means of the advances received from the insured persons and from policy loans. . . . The maintenance of the policies was deemed to be temporary pending a final study and determination by the officers and directors of the best method of disposing of them, and there is nothing to indicate that there existed any other purpose than the ultimate liquidation of the company." *Held:* Not "carrying on or doing business" for capital stock tax purposes.

Western Shore Lumber Co. v. United States (D. C. N. Dist. So. Div. Calif. (1941), 1941 *Prentice-Hall F. T. S.,* par. 62,943 (on appeal) (analyzed, *post,* page 37).

4. If There Is Found to Be an Intention to Liquidate, Whether Formally Expressed or Implied From Its Activities, Then a Corporation Is Not "Carrying on or Doing Business" Merely Because It Puts Forth Its Best Efforts in Disposing of Its Property or Makes Sales of Its Assets, or Even Leases All or Part of Its Assets for Revenue Purposes.

Lane Timber Co. v. Hynson (C. C. A. 5) (1925), 4 F. (2d) 666:

"Owning land is not doing business, nor is paying taxes. Most owners of land, whether a corporation or not, would be willing to sell it at a profit. In our opinion the mere fact that the plaintiff selected agents who might be able to sell its land does not make it liable."

Western Shore Lumber Co. v. United States, supra.

C. Cases Most Nearly Analogous to the Facts Disclosed by the Record Herein, Where Courts Have Held the Corporation Was Not "Carrying On or Doing Business" for Capital Stock Tax Purposes.

Since each decided case must turn on its own peculiar facts, there would be little to gain from an exhaustive treatment of all of the decisions. We have tried, however, to cull from the mass a limited number of decisions which we feel are most closely in point with the facts of our own case as reflected in the record, and feel therefore that they are entitled to great deference.

1. *Union Land and Timber Co. v. United States*, 65 Ct. of Cl. 129, 6 A. F. T. R. 7444:

In that case the plaintiff was incorporated in 1906, had been in business for a number of years with the usual broad charter powers and its main business had been the acquisition of turpentine lands. In 1917, the corporation resolved to liquidate. The activities after this determination to liquidate were described as follows:

> "An office at Mobile, Ala., was continued by the president of the corporation, assisted by one stenographer, designated as secretary. All other officials were dispensed with; and sustained and continued efforts from that time on prevailed to realize the best possible price for the lands owned by the corporation. In the course of so dealing some turpentine leases, or rights to extract turpentine from turpentine trees, were let; and of course efforts were made to get the best possible price for the fee to the lands owned. If offers for the lands or turpentine rights were considered inadequate they were refused and more advanced prices sought. The progress of disposition has been tedious and de-

layed. To dispose advantageously for creditors of a large acreage of turpentine lands at a time when the markets were depressed and demand therefor seriously curtailed has involved years of time and effort, and though the majority of the lands and rights have been sold there still remain holdings undisposed of."

In finding for the plaintiff taxpayer the Court stated as follows:

"A mere repetition of the application of the taxing act to varying conditions of fact, as reflected in numerous opinions of the courts, will serve no special purpose. It is sufficient to observe that the issue is one of fact within the guiding principles of settled law. As said in the case of Von Baumbach v. Sargent Land Co., 242 U. S. 503, 516 (U. S. Tax Cases, 590): 'The fair test to be derived from a consideration of all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails, and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes.'

"We think this case comes squarely within the exception which exempts a liquidating corporation from the capital stock tax. The defendant predicates a contrary opinion upon the fact that at times offers for lands were refused, and negotiations continued to obtain more; that turpentine rights were sometimes let, and finally that the inherent nature of the plaintiff's business was of necessity the doing of the very things it did do—*i. e.*, buy and sell land and turpentine rights, etc., for profit. The charter rights of the corporation

disclose its purposes, and among them was the purchase and sale of lands and turpentine rights; but the continuance of these activities as a going concern, promoted for the purpose of paying dividends to its stockholders, and doing the same things to acquire sufficient funds to pay creditors are distinctly different. One contemplates the present and the future, looks toward an indefinite continuance of business activities. The other is predicated in this case largely upon the misfortunes of the past, and looks exclusively to a disposition to the best advantage of what the corporation has and discontinuing business. No business enterprise could discontinue advantageously without putting forth its best efforts to realize the greatest possible sum for its assets, and the mere fact that in the course of such a proceeding profits may at times be realized, though in this case none are proven, does not designate the transaction as 'doing business' within the intent of the taxing act."

"The plaintiff has not acquired additional lands, it has not paid dividends to stockholders, and all it has done is to dispose, as rapidly as mature judgment and the state of the market would warrant, of all of its tangible investments. Judgment will be awarded the plaintiff."

2. *Estate of Isaac G. Johnson v. United States* (Ct. of Cl.), 37 F. Supp. 617:

In that case the plaintiff corporation was incorporated in 1904 for the purpose of dealing in real estate. The facts in this case, as cited by the Court, are as follows:

"The 'purpose' clause of plaintiff's certificate of incorporation granted broad powers usual to real estate companies, and from its incorporation down to 1929 the

plaintiff engaged in the general activities permitted. In 1929, by a resolution, the plaintiff declared that—

* * * it is the policy of this corporation gradually to liquidate its affairs as its property can be advantageously disposed of and distribute its assets among its stockholders, * * * and distributed a liquidating dividend among its stockholders. Thereafter, the plaintiff discontinued many of the activities previously engaged in and generally reduced its operation to the maintenance and management of its remaining properties and the making of such sales as were deemed advantageous. It continued in that manner to and including the year 1936, and for some time later, but maintained an office with an accountant, two stenographers, and one or two groundkeepers; receiving rents, making repairs, considering and undertaking agency contracts and projects for the favorable marketing of its holdings. During this period it was generally engaged in transactions which had for their purpose the ultimate disposition of existing holdings at a profit. At no time within this period did plaintiff purchase or otherwise acquire any new property, or engage in any activities not necessary for the preservation and care of the property which it then held, and the revenues which might be derived therefrom."

The Court thereupon held that the corporation was not "carrying on or doing business" for the reason that the operations and transactions of the corporation were carried on merely for the purpose of reducing the property of the estate to a form in which it could be readily distributed among the heirs and such activities do not constitute a business.

As in the *Union Land & Timber Co.* case, the Court in the *Johnson* case disregarded individual acts but considered the operations as a whole. It is respectfully submitted that the activities in the *Johnson* case likewise exceed in volume and variety the transactions of the Petitioner in the case at bar.

3. *United States v. Hotchkiss Redwood Co., supra:*

The corporation was organized for the sole purpose of owning and holding a tract of timber land and reselling the same as a whole. Besides maintaining its corporate existence, it issued bonds in the sum of $550,000 secured by a lien on its properties for the purpose of redeeming an earlier bond issue of its predecessor company; levied and collected assessments on its capital stock to pay taxes, interest on bonded indebtedness, and other necessary charges and expenses; to avoid condemnation proceedings, it sold a strip of land for highway purposes for $5,000; paid $50.00 per month salary to secretary and $150.00 per month was paid to president "on account of office expenses"; from time to time corporation has carried on negotiations through its president with prospective purchasers and brokers, looking to the sale of its lands as a whole, but no person or agent has been employed for that purpose; land was never advertised for sale, and no part sold except the strip for highway purposes. *Held:* Not "carrying on or doing business."

4. *Western Shore Lumber Co. v. United States* (D. C. N. D. So. Div. Calif.) (1941) (on appeal) *supra:*

For tax period in question assets of company consisted, as for many years previously, solely of approximately

12,500 acres of timber lands in one county in California and approximately 550 acres of timber lands in another county, and certain cash in bank accounts. During the four year period in question, the company carried on no activities other than the holding and safeguarding of these timber properties and occasional negotiations looking toward their disposition as a whole. During this period there were no meetings of stockholders, but there were three meetings of the board of directors. The action taken at two of these meetings were solely in routine corporation matters, such as the filling of vacant offices, authorizing the employment of auditors, etc., and the only non-routine business transacted at the third directors' meeting was the ratification of a supplemental agreement with the Santa Cruz Lumber Co. by which that company was permitted to cut timber under its existing contract on certain additional land of the taxpayer. Otherwise, taxpayer carried on no activities, sold no lands, etc. Company did, however, employ a secretary at $25.00 per month and a caretaker at $1800.00 per year. The company paid taxes, interest on its indebtedness, miscellaneous office expenses, etc. The company had carried on negotiations looking toward the sale of its property as a whole and on several occasions gave options to prospective purchasers, although no option was given during the tax period in question. The board of directors gave consideration and thought to a method for liquidating the property but was unable to arrive at any program by which it could be liquidated except by a sale to public bodies or by a program of logging contracts which the company did not care to undertake. There were, how-

ever, some receipts from stumpage contracts between the company and the Santa Cruz Lumber Company on a remote part of its properties. Income from these contracts was used to pay taxes upon the property and current expenses, but the taxpayer itself did not engage in logging or stumpage operations. *Held:* That a corporation such as the plaintiff which has reduced its activities to the ownership and the holding of property and the distribution of its avails, and to only such actions as are necessary to the maintenance of the corporation and the private management of its purely internal affairs is not carrying on or doing business within the meaning of the capital stock tax act.

> "The liability of the plaintiff for capital stock taxes must be decided by the purpose for which the corporate organization was maintained and where, as in the present case, there was no intent during the taxable period in question or for many years prior to such period to carry on any active enterprise and the sole purpose of the corporation was to hold on to timber lands and effect a sale of the whole thereof as soon as a fair price could be obtained, the proceeds to be distributed to the stockholders and there was no purpose or activity which constituted efforts or the use of capital in the pursuance of gain or profit, then plaintiff was not carrying on or doing business under the terms of the capital stock tax law."

D. The Supreme Court Decision in Magruder v. Washington, etc., Realty Corp. in No Way Changes the Applicability of the Rules Theretofore Eunciated by the Court in So Far as the Facts Reflected in the Record Herein Are Concerned; and the Board of Tax Appeals Was Clearly in Error When It Based Its Ruling Adverse to Petitioner on the Authority of the Magruder Case.

It should be clear from a reading of Board Member Sternhagen's opinion [Tr. p. 17] that the principal basis for his adverse ruling to the Petitioner was his reliance upon the decision of the Supreme Court in *Magruder v. Washington, Baltimore & Annapolis Realty Corporation,* 86 L. Ed. 858, 62 S. Ct. 922, 316 U. S. 69, decided April 13, 1942, which decision as the record shows was handed down only a few weeks before the Board Member rendered his own opinion in the case at bar. [Tr. p. 19.] Mr. Sternhagen at the very beginning of his opinion summarily disposes of the heart of Petitioner's contention as follows:

> "The petitioner's claim that in the capital stock tax year ending June 30, 1938, it was not carrying on or doing business rests upon the view that its activities of that period were incidental to a long-existing intention to liquidate and were so slight as to be negligible and hence should, for present purposes, be disregarded. As to the intention to liquidate, whatever may have been said as to its significance under earlier decisions must now be revised in view of Magruder v. Washington, Baltimore & Annapolis Realty Corporation, ... U. S. ...... (April 13, 1942); for that decision held a corporation which was expressly formed for liquidation to be subject to the capital stock tax. In the 'nebulous field of confusion' affecting this subject, Article 43(a)

(5) of Regulations 64 was held to be controlling, and in that article liquidation was not *per se* enough to support exemption." [Tr. p. 17.]

There can be no question but that the decision against Petitioner was crucially influenced by the Board Member's belief that the *Magruder* case controlled. The balance of the Board Member's opinion is celarly anti-climactic.

Nor can there be any question but that the Board Member must be charged with a serious misinterpretation and misapplication of the holding of the *Magruder* case.

The crux of the Board Member's analysis of the ruling in the *Magruder* case is that the term "liquidation" as given in Regulations 64, Article 43(a) (5) means liquidation activities of every kind; and according to him it therefore follows that a corporation such as the Petitioner here, which has definitely discontinued the purposes for which it was originally organized, and is now in the process of orderly liquidation, is nevertheless controlled by the provision of Article 43(a) (5) making the corporation subject to capital stock tax, and is not entitled to the exemption from this tax expressly provided for in Article 43(b) (2).

Article 43(a) provides: "In general 'doing business' includes any activities of a corporation whether it engages in . . ."

And subdivision (5) gives as an illustration of a corporation which would be considered as "doing business" one which is engaged in "the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate, and distributing the proceeds as

liquidation is effected—for example the liquidation of an estate, or of properties taken over from another corporation or of the shareholders' interest in particular property."

On the other hand, Article 43(b) (2) grants exemption from the tax to a corporation which is engaged in "the distribution of the avails of property and the doing only of such acts as may be necessary for the maintenance of the corporate status in the case in which the corporation either was organized for or has reduced its activities to, the mere owning and holding of specific property."

Obviously, as Board Member Sternhagen interpreted the ruling in the *Magruder* case there would be no meaning or vitality to Article 43(b) (2) under whose protective cloak Petitioner has constantly sought shelter from the tax. Even a cursory examination of Mr. Justice Murphy's concise opinion in the *Magruder* case should show the error of Mr. Sternhagen's analysis. The Washington, Baltimore and Annapolis Realty Corporation was formed for the exclusive and express purpose of liquidating the assets of another corporation, namely, the Washington, Baltimore & Annapolis Railway Co. It is clear then that liquidation was the very purpose for which the taxpayer was organized. It was equally plain that Article 43(a) (5) was directly in point covering just such a liquidating corporation. The only problem presented to the Court was whether Article 43(a) (5), being an administrative regulation ought to be sufficiently persuasive so as to be controlling. In that connection, Mr. Justice Murphy aptly said:

> "Article 43(a) (5) is both a contemporary and a long-standing adminstrative interpretation, having been

in effect in substantially the same form since 1918, except for the period from 1926 to 1933 when the tax was not imposed. We are of the opinion that it is valid as well as applicable. The crucial words of the statute 'carrying on or doing business' are not so easy of application to varying facts that they leave no room for administrative interpretation or elucidation. To be sure, in many, if not in most instances the factual situation will be so extremely unusual there will be no doubt as to whether a corporation is doing business or not. But the nuances of facts between the two extremes have produced a nebulous field of confusion which has been recognized by courts striving to fit close cases into one category or the other. Interpretative regulations, such as Article 43(a) (5) are appropriate aids towards eliminating that confusion and uncertainty. . . ."

Mr. Justice Murphy in no way devitalizes the validity of Article 43(b) (2). On the contrary, he specifically refers to the regulation, but holds it not to be applicable to a corporation actively engaged in the business for which it was organized, even though that business happens to be the liquidation of its own assets:

"We find without substance respondent's assertions that Article 43(b) (2) is inconsistent with Article 43(a) (5) and that it more exactly fits the facts of this case. During the period in question respondent did not fall into that state of quietude, covered by the specific language of Article 43(b) (2), in which it was merely owning and holding specific property and distributing the resulting proceeds . . . On the contrary, respondent was actively engaged in fulfilling the purpose of its creation, the liquidation of its holdings for the best obtainable price."

In fact it is equally deducible from this opinion that where properly applicable, Article 43(b) (2) is as fully entitled to be considered "an appropriate aid toward eliminating that confusion and uncertainty" which this "nebulous field" has produced, as was in fact accorded by the Court to Article 43(a) (5) on a set of facts where that regulation clearly applied.

The limited number of subsequently decided cases which have referred to the *Magruder* decision, unequivocally point out that the aura of non-taxability has in no way been taken away by that decision from corporations which are not organized for the specific purpose of liquidation but which are in fact liquidating and "distributing its avails."

The North Pennsylvania Rd. Co. v. Rothensies (D. C. E. Div. Pa., May 29, 1942) (45 F. Supp. 486):

> "The Supreme Court held that the liquidating activities of the taxpayer constituted doing business in accordance with interpretive regulation Article 43(a) (5) *supra,* and that Article 43(b) (2) was not applicable. . . . In my opinion the operations of the plaintiff in the instant case fall within the description 'that state of quietude' so aptly phrased in the Magruder opinion."

The Court further held that Article 43(b) (2) was valid in line with the specific holding in the *Magruder* case.

Goodyear Investment Co. v. Collector, (D. C. N. D. E. Div. Ohio) (August 3, 1942), 1942 *Prentice-Hall F. T. S.,* par. 62,948;

Continental Baking Corp. v. Higgins (C. C. A. 2) (July 24, 1942), 1942 *Prentice-Hall F. T. S.,* par. 62,884:

"The recent decision of the Supreme Court in Magruder, Collector v. Washington, B. & A. Realty Corp., 315 U. S.—April 13, 1942, is not *contra*. There a corporation organized to liquidate rights-of-way, terminals, and other real estate which had been purchased at a foreclosure sale by a bondholders' committee, the Washington, B. & A. Realty Co. proceeded to sell the property acquired. It was held that the liquidating corporation was carrying on business within the meaning of the statute. The liquidating corporation was not a holding company at all but one whose corporate activities were liquidation through sale of real estate and whose organization was for that very purpose. The activities of the plaintiff were only those of a quiescent holding company such as fall within the exceptions set forth in Treasury Regulation 64, Article 43(b) (2) and not within Article 43(a) (5) as did those dealt with in Magruder, Collector v. Washington, B. & A. Realty Co., *supra*."

We submit in summary, that the Board Member was clearly in error as to his interpretation and application of the *Magruder* case; and submit further that his failure to clearly base his decision upon any other ground constitutes persuasive evidence of the untenability of the Commissioner's position in face of the declared law prior to the *Magruder* decision and his own Regulations.

E. Viewed in the Light of the Applicable Judicial Guides Which Have Interpreted Section 601 (a) of the Revenue Act of 1938, the Record in This Case Indisputably Shows That the Petitioner Was Not "Carrying On or Doing Business".

Above, we have analyzed to the best of our ability the most pertinent of the vast body of cases which have struggled with the concept of "carrying on or doing business" for capital stock tax purposes. Yet, as confused as the mass appears to be, there does emerge one crystal-clear principle which is armored with uncontravertible judicial authority: namely, *that where the corporation has indicated its intent to discontinue the business for which it was organized and thereafter to "hold on" until it is able to liquidate and "distribute its avails," then the corporation during this passive and "quiescent" period is not considered to be "carrying on or doing business" even though: (1) it may be engaging in such activities as are reasonably necessary to effectuate its liquidation, or (2) it may be engaging in such activities as are reasonably necessary to preserve its properties and conserve its assets, and (3) even though the process of liquidation may be slow, tedious, and proceeds over a period of years.*

It is on the strength of this crucial test that Petitioner has insisted that it had not for a period of eighteen years prior to the taxable year in question been "carrying on or doing business." Below we intend to closely scrutinize the record and the exhibits, and demonstrate the soundness of our contention.

We believe we shall show by the four corners of the record, that:

1. The record shows a clearly defined intention by Petitioner to liquidate its assets as rapidly as conditions reasonably warranted.
2. Such activities as Petitioner engaged in, during the capital stock tax year in question, were not carried on in furtherance of the purposes for which it was incorporated, but rather were reasonably related to (a) the maintenance and preservation of its properties and assets, and (b) the orderly disposal and liquidation of its properties and assets; and
3. The isolated transactions during the taxable year in which Petitioner granted an option or lease for oil exploration purposes did not indicate the seeking of a new source of prolonged business, but rather merely an attempt to create an additional value to the assets which it had for some time past been seeking to liquidate.

1.

The Record Shows a Clearly Defined Intention by Petitioner to Liquidate Its Assets as Rapidly as Conditions Reasonably Warranted.

The Petitioner's Articles of Incorporation specify as its purposes the following:

"Second—That the purposes for which it is formed are to buy and sell land and water, to subdivide land into farm or town lots and sell same, to develop water for domestic or irrigating purposes and sell same, to form stock corporations for the development, use and sale of water, to buy stock of any corporation where water can be obtained for the use of land and to do a

general land and water business in buying and selling same, to incur bonded or other indebtedness, to execute Deeds, Mortgages, Powers of Attorney or other instruments, to facilitate the purchase and sale of land and water, all of which business is to be done for profit."

The Petitioner was active in the development of its land from incorporation until 1919 [Tr. p. 56] and its operations were most profitable, having paid dividends to 1923 of over $3,000,000. [Petitioner's Exhibit No. 7.] In 1923, the Petitioner had about 200 acres scattered in several places. [Tr. pp. 56-57.] These properties were part of Petitioner's original holdings and their sale was slow. The business for which the Petitioner was organized had been abandoned [Tr. p. 79] and has never been revived, as is proved by the following recitals from the record:

1. The first recorded evidence of intention to liquidate occurred on April 17, 1919, when the Petitioner's Board of Directors adopted the following resolution:

> "It was moved by Mr. Sartori, seconded by Mr. Torrance that Mr. Brand, Mr. Torrance and Mr. Chandler be appointed a committee for the purpose of devising and submitting a plan of segregating or distributing all of the remaining lands of this Company and submit a proposition to the Board of Directors." [Petitioner's Exhibit No. 14.]

There is no record that the appointed committee ever acted under this authorization.

2. The fact that the corporation formally reduced its capitalization in 1921 from $1,000,000 to $100,000, is an

overt act in the direction of liquidation. At a directors' meeting on December 10, 1919, the following resolution was adopted:

> "It was moved by Mr. Sartori, seconded by Mr. Marshall that the Company take steps to reduce the capital stock from One Million Dollars to One Hundred Thousand." [Petitioner's Exhibit No. 17.]

More than a year later, on January 24, 1921, a formal Certificate of Diminution of the Petitioner's capital stock in conformity with the above was duly filed. [Petitioner's Exhibit No. 4.]

3. The long-existing intention of Petitioner to liquidate was brought out by the introduction of correspondence between stockholders of the corporation and the Petitioner over a period of years from 1933 to 1937, as follows:

The Petitioner received an inquiry as to its status from the Trust Department of the Security-First National Bank of Los Angeles, dated January 21, 1933 [Petitioner's Exhibit No. 39], in which the Petitioner was asked—

> "If it is possible for you to do so, we should appreciate a copy of the statement of the Company for December 31, 1932, although we realize that little progress has probably been made in liquidating the Company since the statement of December 31, 1930, which you furnished us. May we have your comments as to the present status of this Company?"

In response to this letter, Petitioner replied on March 16, 1933, in part, as follows [Petitioner's Exhibit No. 39]:

> "The Company has made absolutely no progress in its efforts to liquidate and there is little hope of disposing of its holdings under present conditions."

The Petitioner also received a letter from the above stockholder on February 9, 1934, again asking the question "Can you inform us as to how successful the company has been during the past year in conducting the liquidation of its assets?", to which Petitioner on February 16, 1934, replied, in part, as follows [Petitioner's Exhibit No. 40]:

> "We have made absolutely no progress in the liquidation of the assets of this Company, which remain the same as they were a year ago. Receipts from sale of oranges have not even paid current running expenses, and as a result, no taxes have been paid."

On June 8, 1934, Petitioner replied to an inquiry dated June 1, 1934, of the Wells Fargo Bank & Union Trust Co., San Francisco, a stockholder, as to the status of the Petitioner, in part as follows [Petitioner's Exhibit No. 41]:

> "As you will see, practically the only assets of this corporation are the unplotted hill lands of approximately 138 acres and a 40 acre orange grove planted to navels. The only activity of the company is operation of the orange grove, and you will see from the statement the income does not even approximate the expenses. We are using our best endeavors to liquidate the company entirely."

On July 10, 1935, the Petitioner received a letter from Wm. G. Kerkhoff Company, a stockholder, requesting "any information you may have available in connection with its (Petitioner's) affairs," to which Petitioner re-

plied, on July 13, 1935, in part, as follows [Petitioner's Exhibit No. 42]:

> "Up to the time of Mr. Jeffries' death, he tried very hard to dispose of the company as a whole; he also tried to sell the orange grove, the hill lands and the oil rights separately, but without success."

Later in the same year, November 14, 1935, Petitioner replied to the Security-First National Bank of Los Angeles, Trust Department, which had inquired of Petitioner if the shares of Petitioner's capital stock it held could be sold, in part, as follows [Petitioner's Exhibit No. 43]:

> "We regret to inform you that we know of no market at this time for the stock. We have tried for many years to liquidate the final holdings of this company but without success. In the event, however, that we learn of any one who would be interested in purchasing this stock we will get in touch with you."

On November 22, 1937, Petitioner replied to the Security-First National Bank of Los Angeles in answer to its letter of October 22, 1937, in which was asked "Has there been any change in the possibility of the Company's liquidating its assets in the near future?", in part, as follows:

> "You inquire as to the possibility of the company liquidating its assets in the near future. We feel that this will develop into a long drawn-out process. The main assets of the company are the unsubdivided lands and oil reservations of unknown value." [Petitioner's Exhibit No. 46.]

4. The long-existing intention of the Petitioner to liquidate was further brought out by the following statements attached to General Corporate Franchise Tax Returns to the State of California:

> For the year 1926 [Petitioner's Exhibit 47]: "The affairs of this company are being wound up and is practically liquidated."
>
> For the year 1927 [Petitioner's Exhibit 48]: "The affairs of this company are being liquidated and is practically liquidated."
>
> For the year 1928 [Petitioner's Exhibit 49]: "This company is practically liquidated."
>
> Between 1928 and the taxable year in question, the form of the California Franchise Tax Returns was changed so that it no longer was required to state the nature of the corporation's activities.

5. The testimony of R. F. Ingold, president of Petitioner since 1936, shows that he assumed office for the purpose of satisfying the Petitioner's debts and then dissolving the Petitioner as rapidly as possible after disposal of its assets. [Tr. pp. 93-94.]

6. Reference to Petitioner's Exhibits 36, 37 and 51, being respectively the Balance Sheets of the Petitioner on December 31, 1930, July 1, 1937, and June 30, 1938, indicate that the Petitioner had only three assets to be liquidated and that these assets were practically the same on all three dates, namely, a delapidated orange grove, unsalable hill lands, and mineral reservations to 3,000 acres of no established value. For purposes of proof, it was deemed unnecessary to carry the analysis of the

Petitioner's accounts back for more than 6½ years prior to the taxable year in question, but the record shows that the assets on the above dates were also the only assets of the Petitioner as far back as 1923. [Tr. pp. 56-57.] The above assets were unsalable and their disposal was a long and slow process. In support of this, is the following from the record:

a. The testimony of Walter R. Hilker, assistant secretary and director of the Petitioner and connected with Petitioner since 1925, on transcript page 57 stated—

> "Nothing definite was done looking toward the sale of that land between 1919 down to the beginning of the fiscal year that ended on June 30, 1938. By that I mean people in the Valley around the packing house, etc., knew the property was for sale and would have been sold if a purchaser could have been found for it."

On transcript page 59, Walter R. Hilker testified as to the orange grove—

> "This grove is a part of the original 16,000 acres of land of the corporation. It wasn't sold with the other land that had been sold down to 1919 because it was just the tail-end piece of the whole property. Nobody bought it. It was for sale during that period. As to why the corporation continued to maintain the grove, I can only speak from the time I was there, 1925. It was a grove that was taken over with the other assets of the corporation at that time, and we just didn't know what else to do with it. We spent a minimum of money on it to keep it up until we could sell the property. It was for sale during all of that time."

On transcript page 60, Walter H. Hilker testified as to the unplatted hill lands—

> "That was the tail-end of the property owned by the corporation. It had never been platted into city lots or anything. It is just an unplatted tract of land. I have seen it many times. There are no improvements on it; there is no water available to it and no utilities available and no streets. It is remote from any of the established residential sections. I would say that that particular piece of land is about 18 or 20 miles from the center of Los Angeles. This property was a part of the original 16,000 acres of the corporation. It wasn't sold because they never found a buyer for it."

Testimony showed that the oil reservations had no realizable or known value at any time, since they were on unproven oil lands, and are analyzed in greater detail *post,* page 61.

b. Correspondence introduced between the Petitioner and its stockholders also reflected the unsalable nature of the Petitioner's properties and holdings:

Reply to Wm. G. Kerkhoff Co., dated July 13, 1935 [Petitioner's Exhibit No. 42]—

> "You will notice from these statements that the company is not in particularly good financial condition. Its assets consist mainly of a forty acre orange grove planted to navels; some 140 acres of unplotted rolling lands of nominal value and oil right on parts of the Sunshine Ranch, and various other little pieces of land which oil reservations are of unknown value."

Reply to Wells Fargo Bank & Union Trust Co., dated June 9, 1936 [Petitioner's Exhibit No. 44]—

"As to the value of the stock, your guess is as good as ours. You will note that the company is in the unfortunate position where it cannot take care of its real estate taxes, and there just isn't sufficient income to properly take care of the orange grove. . . .

The only other assets belonging to the San Fernando Mission Land Company are 140 acres of unsubdivided rolling hill lands, which the company no doubt would be glad to sell for $200 per acre, but cannot even get a bid for $100 an acre. It also holds oil reservations on a great part of what is known as the Sunshine Ranch. Whether these oil reservations are worth anything is very problematical."

7. The Petitioner had lapsed into a state of dormancy for many years which was evidenced by the following:

a. ". . . the date of the last meeting of directors of the corporation prior to the year 1936, was held on February 2, 1927." [Tr. p. 68.]

b. "The last meeting of shareholders prior to the year 1936, was held on May 28, 1918." [Tr. p. 68.]

"There were no activities at all between the stockholders of the corporation and the corporation during that interval, that is to say, the interval between the holding of the meeting of the directors in 1927 and the time at which a meeting was held in 1936. There was very little interest shown by any of the stockholders in the affairs of the corporation between those dates." [Tr. pp. 68-69.]

c. "There were no meetings of any executive committee of the directors in that interval between the 2nd

of February, 1927, and the time in 1936 when the board proper next met." [Tr. p. 68.]

d. No dividends to stockholders were paid between 1923 and June 30, 1938. [Tr. p. 53.]

e. On September 14, 1936, four of the seven directors of Petitioner had died and not been replaced. Vice-President Sartori had forgotten he held office. Petitioner's president had died and not been replaced. [Tr. pp. 91 and 92.]

8. The Petitioner bought no new land, at any time after 1905. [Tr. pp. 79-80.]

9. The Petitioner was not formally liquidated and dissolved for the following reasons, as summarized by the testimony of W. R. Hilker [Tr. p. 80]:

"The assets were not distributed and the corporation liquidated prior to the close of the fiscal year ending on June 30, 1938, because it wasn't feasible to split up the land and distribute it to the stockholders. Neither was it possible under conditions that we had to sell the property. We couldn't sell the property and distribute the cash. The property was for sale during all of that time. Conditions were much different than the circumstances of the problems involved in a land dividend than the time the corporation paid out a million dollars many years ago. It is my opinion that it would not have been feasible to have distributed the land among the shareholders, that is, the unplotted hill land and the orange grove land."

In summary, it should be clear from this detailed recital that the Petitioner, as originally constituted, was organized for the purpose of engaging in the usual activities of a

subdividing company, created for the purpose of dealing in real estate and water rights at a profit. It carried on extensive business for many years, but it had sold practically all of its properties many years before July 1, 1937, and for many years it had been dormant and it had expressed its intent to liquidate its remaining assets to its shareholders. All of its original purposes therefore had been abandoned and there remained only the tedious task of selling its remaining properties as soon as it could reasonably be done in view of market conditions. Whatever activities it engaged in were obviously not for profit, but incidental to liquidation.

2.

Such Activities as Petitioner Engaged in, During the Capital Stock Tax Year in Question, Were Not Carried on in Furtherance of the Purposes for Which It Was Incorporated, but Rather Were Reasonably Related to (a) the Maintenance and Preservation of Its Properties and Assets, and (b) the Orderly Disposal and Liquidation of Its Properties and Assets.

Petitioner's Exhibit No. 38 and Item 19 under Section IV herein, *ante*, page 13, fully disclose all transactions of the Petitioner for some 6½ years prior to the taxable year in question. The Petitioner's business transactions during this period have been submitted in order to clearly establish the fact that long before the year in question every activity of Petitioner was directed to the sole end of liquidation or maintenance of the corporation's assets and properties.

The extended period required by Petitioner to liquidate its few holdings may be more readily understood when it

is recalled that these assets were unsalable, the Petitioner's operations were unprofitable, and, as a result, no one connected with Petitioner took sufficient interest to vigorously effect its liquidation.

During the six and one-half years prior to July 1, 1937, the Petitioner's activities consisted of the following—

1. It operated an orange and lemon grove not for profit but simply because the management was not able to dispose of it.

The grove had been operated at a continual and substantial loss during the entire period. It was unsalable. It was in bad condition for many years prior to 1930 but after this period its condition became worse and the Petitioner had neither the desire nor the means to invest in rehabilitating it. The question of what to do with the grove had confronted the Petitioner for many years and it has been clearly established that the only reason Petitioner retained the grove was that it hesitated to abandon it as a total loss before being forced to do so.

2. It sold one small parcel of less than 2 acres of its land in 1932, which was in pursuance of its intent to liquidate.

This was the only sale of land by Petitioner in the whole six and one-half years.

3. It sold its retained mineral interest in a small parcel of its holdings in 1936, to the surface owner of the land, which was in pursuance of its intent to liquidate.

This was the only sale of mineral interests made by Petitioner in the entire six and one-half year period.

4. It received $10.00 in 1931 for a quit-claim deed to clear title on a previous transaction, and it received $75.00 in 1935, for use of its hill land for pasture purposes, these transactions being so incidental and insignificant that they may be disregarded.

5. It paid or incurred property taxes, franchise taxes, interest on money borrowed, and nominal administration expenses during the period, but all were nominal in amount and related solely to the maintenance of its assets.

In the taxable year in question, being the period from July 1, 1937, to June 30, 1938, the activities of Petitioner were of the same nature as these recited in the 6½ years previous and they were all directed to the same end of liquidation or maintenance of the Petitioner's assets and properties. During this year, the Petitioner's activities consisted of the following (*ante,* page 18 herein and Petitioner's Exhibit No. 50):

1. It sold a small parcel of 4.75 acres of its remaining unplotted and unimproved hill land, which was in pursuance of its intent to liquidate.

2. It sold a mineral reservation interest in a single piece of property to the surface owner of the land, which, again, was in pursuance of its intent to liquidate.

3. It received final proceeds from its orange groves, which was abandoned during the year, some pasture rental, and other small items which did not amount to $200.00, and which were incidental to its ownership of the property.

4. It incurred expenses in upkeep of the grove until abandoned and for certain expenses incident to pulling

out the trees upon abandonment of the grove, but these activities were involved not in an operation for profit but, on the contrary, strictly in liquidation of the Petitioner's investment in the grove.

5. It paid or incurred expenses for property taxes, franchise taxes, and sundry items, all being nominal in amount and related solely to the maintenance of its assets.

6. It loaned the Angeles Mesa Land Co., a 10% stockholder, the sum of $1,500.00 on open account, without interest, purely as an accommodation. This transaction was obviously entered into without expectation of profit and, as such, is not a transaction coming within the concept of "carrying on or doing business."

> *Rose v. Nunnally Inv. Co.,* 22 F. (2d) 102;
> *Automatic Fire Alarm Co. of Del. v. Bowers, supra.*

7. It entered into an oil and gas lease on part of its mineral reservation interests. This entire subject of the true nature of Petitioner's mineral reservation interests is fully analyzed on *post,* pages 61 to 72, but for present purposes, it is respectfully submitted that this one lease, in and of itself, is a transaction which is properly in harmony with Petitioner's position that it was not doing business but that its activities were incidental to liquidation.

In summary, therefore, it is respectfully submitted that the Petitioner's activities and situation in its entirety in the taxable year in question and for many years prior thereto, were all in pursuance of its intent to liquidate or maintain its assets and properties and that nothing arose to change this clear course at any time prior to June 30, 1938.

3.

The Isolated Transactions During the Taxable Year in Which Petitioner Granted an Option or Lease for Oil Exploration Purposes Did Not Indicate the Seeking of a New Source of Prolonged Business, but Rather Merely an Attempt to Obtain an Additional Value to the Assets Which It Had for Some Time Past Been Seeking to Liquidate.

In his "Findings of Fact" [Tr. p. 14]; and in his "Opinion" [Tr. p. 17] Board Member Sternhagen refers here and there to the reservation by Petitioner of mineral rights to approximately 3,000 acres of its original 16,000 acre holdings and to occasional transactions involving leasing for oil explorations. In his Opinion particularly, the following statement is made:

> "That it was ready to do whatever business came its way and make whatever current profit was available is shown by the evidence of substantial transactions later in 1938 involving oil leases for long terms. This activity was not a departure from earlier plans and practices; similar attempts were made in the tax year. At the meeting of September 14, 1936, it considered leasing its oil rights and thereafter actively sought to do so." [Tr. pp. 18, 19.]

It is Petitioner's position that the Board Member has given unwarranted emphasis to sporadic transactions which were clearly incidental to a landowner's attempts to liquidate its assets. Psychologically, it is evident why the overemphasis has been made. In the latter part of 1938, Petitioner executed two leases of its mineral oil rights covering certain acreages, for substantial bonuses. Applying the "hindsight rule" which is certainly a human

frailty, the Board Member has in his mind's eye magnified every isolated transaction which may happen to relate to oil exploration on Petitioner's land, and piecing together these transactions which have occurred over a period of twenty years, he makes the entirely unwarranted inference that Petitioner has actively engaged in the business of oil exploration.

We intend to show by close examination of the record, including the oral testimony, the minutes of stockholders' and directors' meetings, and correspondence, that whatever transactions Petitioner may have engaged in relating to oil activities were entirely and always consistent with its declared purposes to liquidate its properties; that at no time did Petitioner engage in oil exploration as such; that the lucrative leases executed by Petitioner after June 30, 1938, clearly constituted a "windfall."

Now, let us look at the record:

1. All the mineral reservation interests of Petitioner arose out of a single transaction in 1919, and the reservation was merely incidental to this transaction and not a new course of business for Petitioner.

(a) On May 23, 1919, Petitioner sold all its remaining land of approximately 3,000 acres, excepting the two parcels still owned in the tax year in question, to The Sunshine Company; the sales price of this bulk sale was so low that the mineral interests were retained. [Tr. pp. 98 and 56.]

(b) Since these reserved mineral interests were on land which the Petitioner acquired upon its incorporation [Tr. p. 62], this transaction, therefore, was not a new investment by Petitioner but merely a change in the form of Petitioner's ownership.

2. In the course of the subsequent 20 years from 1919 to June 30, 1938, Petitioner never considered the mineral reservations of any value.

(a) Between 1919 and 1936, the mineral reservations were not even reflected on Petitioner's books as an asset. [Tr. p. 63.]

(b) In 1936, Petitioner's bookkeeper set the mineral interests on the books at a nominal value of $1.00, merely to place something on the books which would recognize the possible existence of the rights. [Tr. p. 87.]

(c) The testimony of Walter R. Hilker established the fact that at no time prior to June 30, 1938, did the Petitioner consider the oil reservations as having any value. [Tr. pp. 81 and 88.]

(d) The testimony of Reuben F. Ingold also established the fact that Petitioner did not believe that the mineral reservations had any value even in 1936. [Tr. p. 98.]

(e) Correspondence, between 1933 and 1937, with stockholders, who were inquiring as to the Petitioner's financial condition and its progress towards liquidation, seldom even mentioned the mineral reservations as being assets of the Petitioner and when mention was made, the interests were described as being of unknown or problematical value only.

Petitioner's Exhibit No. 41, dated June 8, 1934, describes the corporation's assets on December 31, 1933, as follows:

"As you will see, practically the only assets of this corporation are the unplotted hill lands of approximately 138 acres and a 40 acre orange grove planted to navels."

Petitioner's Exhibit No. 42, dated July 13, 1935, describes Petitioner's assets on December 31, 1934, as follows:

> "Its assets consist mainly of a forty acre orange grove planted to navels; some 140 acres of unplotted rolling lands of nominal value and oil rights on parts of the Sunshine Ranch, and various other little pieces of land which oil reservations are of unknown value."

Petitioner's Exhibit No. 44, dated June 9, 1936, describes the oil reservations as follows:

> "It also holds oil reservations on a great part of what is known as the Sunshine Ranch. Whether these oil reservations are worth anything is very problematical."

Petitioner's Exhibit No. 46, dated November 22. 1937, states:

> "The main assets of the company are the unsubdivided lands and oil reservations of unknown value."

(f) Petitioner was never acquainted with, nor did it ever have a survey or study made by experts to determine whether there was a probability or likelihood of there being oil or minerals upon any of Petitioner's interests. [Tr. pp. 89 and 103-104.]

(g) There has been no oil production whatever on Petitioner's land at any time. [Tr. pp. 89 and 105.]

(h) As has been shown in the record, the Petitioner was dormant for many years, during which time it had no activity of any kind, let alone any activity with respect to its oil reservations. [Tr. pp. 68-69.]

3. In the course of the subsequent 20 years from 1919 to June 30, 1938, the few transactions which Peti-

tioner had with respect to these mineral interests were in furtherance of its long-existing intent to liquidate and not in carrying on an oil leasing business.

a. A full recital of every transaction with respect to its oil reservations between 1917, the first time any reference was made to its oil interests, and June 30, 1937, the beginning of the taxable year in question, indicates that in this 20 year period, Petitioner had only incidental and occasional transactions, that all such transactions were small in amount, and that these transactions were the normal opportunities of any owner of property rather than the acts of a corporation in the oil leasing business.

1. Between the years 1917 and 1919 the transactions which might be considered relating to oil rights were so minor and inconsequential that we do not take the space necessary to recite them. [Petitioner's Exhibits 10, 11, 14.] However, in 1919, as we have indicated above in connection with the sale to The Sunshine Company, the Petitioner did reserve mineral rights to the approximate 3,000 acres then disposed of. This sale in fee disposed of practically all of Petitioner's real estate except the two parcels which it retained up to the tax year in question.

2. Between 1919 and 1925, Petitioner had no transactions in its mineral interests.

3. In 1925 [Respondent's Exhibit "H"] Petitioner considered two oil lease proposals but rejected both and no further action was taken. Rejection of an offer to lease is consistent with the right of Petitioner to obtain a good price for its assets and such refusal does not alter an intent to liquidate. A liquidating concern may put forth its best efforts to realize

the greatest sum for its assets without thereby converting its liquidating activities into that of "carrying on or doing business."

The Union Land & Timber Co. v. United States, supra.

4. In 1927 [Petitioner's Exhibit 6] Petitioner took the following action in connection with its mineral reservations:

It accepted the sum of $2,940.00 for granting quitclaim deeds to mineral interests it had reserved when the land was previously sold. As recited in the minutes, Petitioner had promised to release the mineral interests at the time of sale, and this action was taken in conformity with such promise and not as a separate transaction.

It received two oil lease offers, rejected one and accepted the other providing for a bonus on execution and royalty on oil. No oil was ever discovered, no royalty ever received, and the lapse of some 10 years between this date and the taxable year in question would certainly indicate that this transaction did not ripen into a sufficiently important aspect of Petitioner's business to constitute a new source of profit.

It voted not to authorize the execution of any more oil releases by the Petitioner "for the present, at least."

This was a minor transaction, as evidenced by the fact that Walter R. Hilker who was present at said meeting did not recall the reason for such action [Tr. p. 81].

It would appear obvious however, that this action is completely inconsistent with any interpretation that Petitioner had entered the oil leasing business. If it were in the oil leasing business, it certainly would not

logically decide to discontinue making leases; on the contrary, it would certainly have aggressively sought such leases.

It refused to quit-claim its reserved mineral rights which were retained on The Sunshine Company transaction to the later surface owners (The California Trust Co.). No consideration was mentioned in the minutes and none was offered. This action clearly indicates that the considered worth of the mineral interests at that time was zero. And as to the Petitioner, its refusal to release its reservations for no consideration is certainly understandable. An intent to liquidate does not require blind acceptance of every opportunity to dispose of its assets, on the contrary, it may endeavor to obtain the best possible price for its properties at all times.

5. For almost 10 years, from 1927 to September 14, 1936, Petitioner held no directors or executive committee meetings, and no oil reservation transactions were had. [Tr. pp. 68 and 69.]

6. On September 14, 1936, a directors' meeting was held [Petitioner's Exhibit No. 2] in which the following transactions relating to Petitioner's oil reservations were had:

It sold for $7,500.00 its reserved mineral rights in and to approximately 233 acres to the Associated Oil Company, the owner of the surface land. This transaction is consistent with Petitioner's intent to liquidate since by this sale, Petitioner retained no further ownership in the interests and such a transaction resulted in reducing its assets to cash.

It refused to enter into an oil and gas lease with the Progressive Syndicate which provided for no lease bonus. As previously stated, a refusal to accept an

offer is not in itself inconsistent with an intent to liquidate. Further, the opportunity to make a lease for no bonus is not proof of value, particularly when this was the one and only offer since 1927.

It refused to release its mineral interests to the California Trust Company, the surface land owners. As stated in the Record [Tr. p. 98] no consideration was offered for this release but the Petitioner felt that since the original sale was at a very low price and that if the reservations were to be released, the Petitioner should be paid therefor. There was no thought of value to the interests in this decision by Petitioner.

b. During the taxable year in question, Petitioner had only the following transactions relating to its mineral reservations:

It sold to John O'Melveny, the surface owner, its reserved mineral interest in land that he owned, for a total consideration of $1,180.00. As previously discussed, this sale of Petitioner's interest was in direct furtherance of Petitioner's plan to liquidate, it retaining no further interest in this property.

It authorized a lease to one Wm. McClintock on November 10, 1937 [Petitioner's Exhibit No. 24] but this lease was never consummated. No bonus or other consideration was received for this lease and, in order to avoid clouding Petitioner's title, it was placed in an escrow pending actual starting to drill on the property. Lessee never started to drill and at the end of 3 months, as provided, the escrow was cancelled and the lease was never delivered to the lessee. Thus, the transaction was never consummated and, as far as the Petitioner is concerned, was never in effect. The precautions taken

by Petitioner to insure performance by the lessee were merely good business judgment, particularly so when there was no requirement on the part of the lessee to make any immediate investment in the lease. There is no requirement, under the law, that liquidating companies use less caution in their transactions than any others, or forfeit their intent to liquidate if they do so.

It entered into an oil and gas lease on part of its mineral reservation holdings with one A. Llewellyn Howell on March 16, 1938 [Petitioner's Exhibits 25 and 28]. No bonus or consideration was received and rental was to be paid after six months in the event he did not start to drill. Lessee did not start to drill prior to June 30, 1938 [Tr. p. 100]. The Howell lease was merely an option since Howell paid nothing for the lease and the only recourse of Petitioner in the event that Howell failed to drill or pay rental if he so failed to drill, was to cancel the lease. This lease was purely speculative and the circumstances under which this lease was made were no different than those which existed for many years previously. As stated at Tr. page 114, Petitioner had an opportunity to lease the property on the basis of rentals for six months. It had not changed the Petitioner's purpose of liquidating as rapidly as possible. The Petitioner still planned to sell whatever assets it had. If drilling operations were successful, Petitioner could then have determined a value on the oil rights or it could have distributed them to the shareholders.

In *Lyon Lumber Co. v. Harrison* [113 F. (2d) 443], plaintiff had executed an option for an oil lease, among other activities, and defendant contended that this constituted an act of "doing business." The Circuit Court stated that such an activity was in harmony with plaintiff's

claim that it was not doing business and that if that was all plaintiff did, the execution of an option for an oil lease was not in and of itself an act of "doing business." In the instant case, this lease was the only act of Petitioner in connection with leasing of its mineral interests and, under the above circumstances, is not in and of itself an act of doing business.

Finally, the advantage to Petitioner in establishing a value to its long held and unknown mineral interests in furtherance of its intention to liquidate appears obvious. Any distribution of its mineral interests as long as they were of unknown or speculative value would merely have served to have hopelessly clouded the title to said interests. With many persons owning undivided interests, any opportunity of leasing such interests would have been impossible. On the other hand, had a value been created, then distribution could have been made without any complications. The only recourse of Petitioner was to hold such interests until their disposal or until a real value had been created by finding oil.

The above recital represents every transaction, whether consummated or not, by Petitioner with respect to its mineral interests from 1917 to June 30, 1938. We can find nothing in such record reflecting anything other than incidental transactions which arose simply by virtue of Petitioner's ownership in the mineral interests. The sales of mineral interests were in direct furtherance of Petitioner's intended liquidation just the same as the sale of any of its other assets. Petitioner had but two oil leasing transactions in the entire 21 year period—one in 1927 in which oil was never found and which was followed by

a period of almost 10 years of complete dormancy of the Petitioner, and the other in 1938, which was merely an option on a speculative basis. It is respectfully submitted that the two lease transactions cannot be so magnified in importance, either by themselves or in view of the expressed intent of the Petitioner to liquidate, so as to convert Petitioner's activities into those of an oil leasing company.

4. The leases on which Petitioner received bonuses in 1938 arose in their entirety after the taxable year in question and were not the result of any prior plan of Petitioner, but were purely "windfalls."

(a) The Tidewater-Associated lease was executed on August 26, 1938, providing for a $20,000 bonus, and the Shell lease was executed on November 25, 1938, providing for a $76,130.00 bonus. [Tr. pp. 104-105 and Petitioner's Exhibits No. 29, 30.]

(b) The testimony of both Ingold and Hilker indicate that Petitioner did not seek out the Tidewater-Associated Oil Company but rather that Petitioner was approached by representatives of said company on August 19, 1938, and negotiations were then started resulting in the lease dated August 26, 1938. [Tr. pp. 103 and 115.]

(c) After the execution of the Tidewater-Associated lease, and on the basis of this lease, the Petitioner retained Robert V. New to solicit an oil lease on other property owned by Petitioner, resulting in the Shell lease of November 25, 1938. [Tr. pp. 106-107.]

(d) Petitioner had no knowledge of any leasing activity in the vicinity or of any oil interest at any time prior to August 19, 1938. [Tr. pp. 105, 113 and 115.]

(e) No oil has been found on the properties leased. [Tr. pp. 105 and 109.]

(f) The act of Petitioner in fixing a zero value on its 1938 Capital Stock Tax Return which was filed in the latter part of July, 1938, is further evidence that Petitioner was not aware of the making of the above leases at that time. [Tr. p. 112.]

VI.

Conclusion.

While we stand humble before the burden which is placed upon Petitioner in face of the adverse ruling of the Board of Tax Appeals, yet we are strong in the belief that we have fairly and substantially sustained that burden.

The Board Member, we are satisfied, would not have decided adversely to Petitioner had not the Supreme Court handed down its opinion in the *Magruder* case, thus seemingly affording him a ready-made answer to his problem. Had more care been exercised in his analysis, we are satisfied the Board Member would have been convinced, too, that the *Magruder* decision had no applicability to the facts of our case.

Fairly and properly appraised—and not swayed by the glow of an unforeseen bonanza which fell into Petitioner's lap after the taxable year in question—it should be plain that (1) Petitioner has for a good many years concentrated its efforts on the liquidation of all of its assets; (2) that in the taxable year in question Petitioner was left holding only a few of its unsalable assets, and was not engaged in any activities for the end of profit other than

were incidental to the maintenance, conservation, or disposal of its remaining assets, and (3) that its occasional and sporadic transactions anent the leasing of its reserved oil rights cannot by any reasonable interpretation be considered as a new venture for profit, but constituted a perfectly normal attempt by a liquidating company to set a measure of value on its remaining assets, including the reserved mineral rights.

Considered as a whole, in the light of the rules which the courts have laid down as guides, it is our position that Petitioner was not, from July 1, 1937, to June 30, 1938, "carrying on or doing business" within the meaning of the applicable statutes and regulations.

For these reasons, the Judgment of the Board of Tax Appeals should be reversed.

Respectfully submitted,

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